

Clearly, no one would be clamoring for a cost of capital adjustment if interest rates had not declined since the implementation of price cap regulation on January 1, 1991.⁶⁰ If the Commission requires a one-time adjustment in LEC PCIs to reflect a change in interest rates or the cost of capital, it will undercut the foundation of price cap regulation.

Furthermore, any such adjustment would, for all intents and purposes, constitute a re-prescription of the cost of capital for price cap LECs. Neither the price cap rules nor the Part 65 Rules allow for a cost of capital prescription to reset LEC price cap rates. However, it is U S WEST's opinion that if the Commission modifies its price cap rules to allow for a cost of capital adjustment, the Commission would be required first to conduct a rate prescription proceeding "after full opportunity for hearing, upon a complaint or under an order for investigation and hearing made by the Commission on its own initiative."⁶¹

If the Commission determines that a cost of capital adjustment is necessary, U S WEST expressly reserves the right to make a proper evidentiary showing as to the appropriate rate of return for its interstate access services. GSA, an advocate of a cost

⁶⁰The question of whether LEC capital costs are less than the 11.25 percent rate that was prescribed prior to price cap implementation is a different issue. At the time, LECs found 11.25 percent to be an unreasonably low figure and presented evidence to support a higher cost of capital. USTA Reply at Attachment, Report of Dr. Randall S. Billingsley ("Billingsley Report") at Exhibit No. RSB-5 at 4.

⁶¹47 USC § 205(a). The Commission's Price Cap Review Notice of Proposed Rulemaking satisfies neither the statutory language of the Communications Act, the notice requirements of the Administrative Procedure Act (5 USC §§ 557, 702), nor the Commission's own Part 65 Rules (47 CFR § 65).

of capital adjustment for price cap LECs, recognized that the Commission cannot reset LEC PCIs for cost of capital changes without a formal prescription proceeding.⁶² The Commission cannot simply ignore its existing re-prescription procedures and engage in ad hoc decision making.⁶³

The Commission should decline to address the issue of cost of capital adjustments in a price cap proceeding. The Commission has already found that price cap regulation is a more efficient form of regulation than rate of return regulation.⁶⁴ Cost of capital adjustments have no role in price cap regulation.⁶⁵ The Commission would not be engaging in "reasoned decision making" if it adopted a cost of capital adjustment in the instant proceeding.⁶⁶

⁶²GSA at 6.

⁶³See Nat. Cable Television v. FCC, 747 F.2d 1503, 1509 (D.C. Cir. 1984). See also Reuters Ltd. v. FCC, 781 F.2d 946, 950-51 (D.C. Cir. 1986) ("an agency must adhere to its own rules and regulations. Ad hoc departures from those rules, even to achieve laudable aims, cannot be sanctioned."); FERC v. Triton Oil and Gas Corp., 750 F.2d 113, 116 (D.C. Cir. 1984) ("The Commission may not abuse its discretion by arbitrarily choosing to disregard its own established rules and procedures in a single case.").

⁶⁴Price Cap Order, 5 FCC Rcd. at 6790 ¶ 29.

⁶⁵See Billingsley Report at 12-17. In addition to addressing the issue of whether cost of capital adjustments have any role in a price cap plan, Billingsley points out the flaws in the cost of capital studies and arguments contained in MCI's and AT&T's comments.

⁶⁶See, e.g., Telephone and Data Systems, Inc. v. FCC, 19 F.2d 42, 50 (D.C. Cir. 1994); City of Brookings Mun. Telephone Co. v. FCC, 822 F.2d 1153, 1168, 1171 (D.C. Cir. 1987); People of State of Cal. v. FCC, 905 F.2d 1217, 1234, 1238-39 (9th Cir. 1990).

IV. OPPONENTS' PRODUCTIVITY PROPOSALS CANNOT BE RECONCILED WITH REALITY AND ARE INHERENTLY UNFAIR TO PRICE CAP LECs

In their quest to obtain even lower access rates, several commenters argue that the productivity factor in the LEC price cap formula should be increased significantly.⁶⁷ These parties base their productivity arguments on claims of excessive LEC earnings since the adoption of price cap regulation. U S WEST disagrees with both opponents' productivity conclusions and their claims of excessive LEC earnings.

Total factor productivity is a measure of efficiency that uses "real" inputs and outputs and attempts to remove all effects of nominal price changes. In and of itself, productivity change says nothing about profitability.⁶⁸ Rate of return, on the other hand, is a regulatory accounting concept which incorporates all price changes. It is quite possible for a firm to show increasing accounting profits when its total factor productivity is actually declining.⁶⁹ Trying to translate LEC profits into total factor productivity change, as AT&T proposes, cannot be

⁶⁷AT&T at 23-24; Ad Hoc at 21; GSA at 8-10; MCI at 18; OCCO at 7; WilTel at 25; PaOCA at 6-7; ICA at 11-13; Sprint at 11-12.

⁶⁸Of course, any firm which is increasing its productivity would be better off than a firm which is not. A firm with higher productivity, ceteris paribus, should have higher profits or lower losses than a less efficient firm.

⁶⁹This is not nearly as unusual as it may sound. In fact, it is quite common during times of high inflation, as economists frequently note. Furthermore, the relationship between accounting profits and productivity becomes even more tenuous in cases where regulated firms (i.e., LECs) are not allowed to use realistic depreciation rates for regulatory accounting purposes.

supported.⁷⁰ This approach becomes even more questionable when one considers that AT&T used only RBOC data and failed to include data on GTE, the largest LEC subject to price cap regulation.⁷¹

Furthermore, the inherent assumption in AT&T's approach that the time value of money is zero is ridiculous.⁷² AT&T calculates "productivity differentials" for the 1991-93 period by comparing RBOC rates of return to the previously authorized 11.25 percent rate of return that was used to establish initial price cap rates.⁷³ On the basis of this approach, AT&T concludes that the price cap LEC productivity offset should be increased by 2.67 percent, to 5.97 percent. The Commission should reject AT&T's study in its entirety. It is fatally flawed both in terms of methodology and inputs and its conclusions can only be described as highly inaccurate and speculative. It is not necessary to take such a highly convoluted "back door" approach to productivity when price cap LECs have placed a total factor productivity

⁷⁰AT&T at 24, Appendix B.

⁷¹In fact, GTE's earnings have been significantly lower than the average of the RBOCs for the 1992-93 period. GTE at 15.

⁷²By assuming that a dollar of earnings in any given year is equivalent to a dollar of earnings in any other year, AT&T is assuming that the time value of money is zero.

⁷³AT&T's analysis totally ignores the fact that many LECs are priced below their caps. Moreover, AT&T's study uses only LEC PCIs. As such, the link between LEC earnings and AT&T's productivity estimates is even more speculative.

study on the record⁷⁴ and subsequently provided input data in response to Ad Hoc's request.⁷⁵

MCI proposes that the Commission engage in "revisionist" history and revise the short-term productivity study the Commission used to establish the original 3.3 percent productivity factor (i.e., including the consumer productivity dividend ("CPD")).⁷⁶ MCI offers no additional analysis or data and argues that on the basis of its proposed change, the Commission should raise the productivity factor to 5.9 percent (i.e., including the CPD). MCI uses this same approach to justify a one-time reduction in LEC PCIs of 7.5 percent to reflect the understatement of the productivity factor over the last three years.⁷⁷ The Commission should disregard MCI's productivity comments in their entirety. The purpose of this proceeding is to review price cap regulation after three years of experience. At a minimum, parties should be expected to put new information on the record -- not to suggest that studies for previous periods be revised. If anything, MCI's productivity comments support the continued use of a 3.3 percent productivity factor, the factor the Commission found to be reasonable when price cap regulation was first adopted. There is even less justification for MCI's

⁷⁴See USTA at Attachment 6, Productivity of the Local Telephone Operating Companies Subject to Price Cap Regulation, by Lauritis R. Christensen, Philip E. Schoech, and Mark E. Meitzen.

⁷⁵See Response of the United States Telephone Association to Ad Hoc's Motion to Compel and Motion for Extension of Time filed herein June 2, 1994.

⁷⁶MCI argues that the data point for the 1984 tariff year should be eliminated. MCI at 21.

⁷⁷Id. at 26-27.

proposed one-time productivity adjustment. It is nothing more than retroactive ratemaking.⁷⁸

Ad Hoc and its experts assert that the Commission must reformulate its productivity offset to reflect the fact that LEC input prices are rising at a slower rate than the GNP-PI.⁷⁹ U S WEST opposes Ad Hoc's proposal. As NERA's analysis concludes, there is no basis for the assertion that LEC input prices are growing at a slower rate than the GNP-PI.⁸⁰ Even if it were true that LEC input prices are growing at a different rate than the GNP-PI, whether it be faster or slower, it would be inconsistent with price cap regulation to incorporate such an adjustment. This would be the equivalent of a general exogenous adjustment for changes in the prices of LEC inputs. Adoption of such an adjustment would re-introduce many of the distortions that exist under a cost-plus rate of return approach to regulation.⁸¹ The

⁷⁸The rule against retroactivity as a cardinal principle of ratemaking is laid out in a host of cases. See, e.g., City of Piqua, Ohio v. Fed Energy Regulatory Com'n, 610 F.2d 950, 954-55 (D.C. Cir. 1979); Illinois Bell Telephone Co. v. FCC, 966 F.2d 1478, 1482 (D.C. Cir. 1992), reh'g denied (Nov. 2, 1992); Southern California Edison Co. v. FERC, 805 F.2d 1068, 1070 n.2 (D.C. Cir. 1986). See also Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571 (1981).

⁷⁹Ad Hoc at 17-21, Appendix at 47-54.

⁸⁰USTA Reply at Attachment, Economic Performance of the LEC Price Cap Plan, by the National Economic Research Associates, Inc., at 4-6.

⁸¹The Commission declined to adopt exogenous cost treatment for depreciation costs in its original LEC Price Cap Order. Price Cap Order, 5 FCC Rcd. at 6809 ¶¶ 182-87. Most of the reasons that the Commission cited for not treating depreciation charges as exogenous costs are equally applicable to a cost adjustment for LEC input prices.

Commission should reject Ad Hoc's proposal as contrary to the goals and principles of price cap regulation.

In summary, commenters have presented no reliable evidence to indicate what the actual level of LEC productivity gains have been under price cap regulation. Even if they had, it would not be appropriate to revise the price cap productivity factor on the basis of three years of experience.⁸² U S WEST believes that the LEC productivity factor should reflect productivity gains over a longer period of time.⁸³ At a minimum, this period should be no shorter than the period since divestiture. Adjusting the productivity factor to reflect gains since the inception of price caps or through a one-time adjustment in the PCI is nothing more than an attempt to recapture LECs' share of price cap productivity gains. This would diminish LEC incentives going forward and send the wrong signals to customers, competitors, and financial markets.⁸⁴

⁸²It would indeed be ironic if the Commission established a productivity offset significantly above the three percent factor used in the AT&T plan. Historically, long distance communications have enjoyed much greater productivity gains than local exchange operations. See In the Matter of Price Cap Performance Review for AT&T, Report, 8 FCC Rcd. 6968, 6970-71 ¶¶ 21-22 (1993) ("In addition, none of the comments propose any change in the productivity factor, or provide any evidence for such a change. In the present case, these considerations support continuing the present 3 percent productivity factor.")

⁸³Total factor productivity of individual companies and price cap LECs as a group has shown considerable volatility over time. It would be unwise to modify the productivity factor in the LEC price cap plan on the basis of recent productivity levels which may be unsustainable over any period of time.

⁸⁴The Commission should not lose sight of the fact that any interested party may file a § 208 complaint if it believes that LECs have engaged in unreasonable pricing behavior. The fact that some price cap LECs have earned higher returns under price
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V. THE PUBLIC INTEREST WOULD NOT BE SERVED BY FURTHER
RESTRICTIONS ON LECs' ALREADY LIMITED PRICING
FLEXIBILITY

In discussing pricing flexibility and pricing standards for new and existing LEC services, it seems everyone, except for LECs, has "a better idea" as to how LECs should be further restricted. Large IXCs oppose upward pricing flexibility and favor lower LEC prices.⁸⁵ Small IXCs oppose volume discounts and favor very tightly controlled rate relationships between high capacity services (i.e., DS1 and DS3).⁸⁶ CAPs oppose downward pricing flexibility and favor high prices for competitive services.⁸⁷ Virtually all of these parties claim to favor competition and assert that adoption of their proposals will prevent discrimination and cross-subsidization. It is all but impossible to reconcile the claims of the parties.⁸⁸ The only common denominator is that the positions of IXCs and CAPs reflect their private interests.

In the eyes of the CAPs, almost any LEC competitive response is an anticompetitive response which requires even greater

⁸⁴(...continued)
cap regulation is not an indication that LEC prices are unreasonable -- only that some LECs have operated more efficiently than others.

⁸⁵MCI at 53; AT&T at 42-45.

⁸⁶CompTel at 6-15; WilTel at 30-33.

⁸⁷MFS at 12-33; TCG at 24-25; ALTS at 30-32.

⁸⁸In arguing that the Commission should adopt a cost consistency test for LEC pricing, MFS goes so far as to assert that "the 'expected level of competition' is precisely the wrong basis upon which to designate pricing categories." MFS at 15.

regulatory oversight.⁸⁹ If the CAPS had their way, LEC pricing flexibility would be limited to a very narrow range at a relatively high price level.⁹⁰ This would serve CAP interests by establishing a LEC price umbrella under which they could establish prices for the segments of the interstate access market which they chose to serve. While there is no doubt that this approach would protect CAPs and help them prosper, it would not

⁸⁹"TCG believes that the current price cap baskets and bands are reasonably appropriate. . . . Assuming . . . that a degree of competition in certain markets was detected, the next question is what changes, if any should be implemented in price cap regulation . . . [T]he Commission should rely on imputation and price cap pricing restrictions to discourage LECs from undertaking anticompetitive pricing strategies. Accordingly, in the event that a degree of competition was detected in a particular market, the Commission's first action should be to put in place price cap rules to inhibit LECs from cross subsidization of unreasonably low rates in that market. Only when competition reaches the levels that AT&T experienced when the Commission deregulated its services will it become appropriate for the Commission to consider additional flexible regulation of LECs." TCG at 9-11.

⁹⁰The most extreme example of such a proposal is MFS' cost consistency test which would require LECs to maintain a relatively constant price/cost ratio (i.e., plus or minus ten percent) for all individual rate elements in the trunking basket. MFS at 17-21. While MFS claims that its proposal does not require allocation of overheads and is not cost-plus pricing, the result would be essentially the same. Not only would MFS' proposal unduly restrict LEC pricing flexibility for competitive services, it would be an administrative nightmare. MFS noted that the Commission had rejected a similar proposal for rate element banding in the Price Cap Order, but asserted that this change would be "quite easy to implement," given LECs' experience with the TRP process. MFS at 20 n.17. The Commission's concerns over the administrative burden associated with adopting an overly complex proposal such as MFS' cost consistency test are as valid today as they were when the LEC price cap plan was first adopted. Price Cap Order, 5 FCC Rcd. at 6813 ¶ 222. As such, the Commission should reject MFS' cost consistency test.

serve the Commission's interests of increasing competition in the interstate access market.⁹¹

If the Commission is serious about its goal of increasing access competition, it should identify LEC services which are subject to competition and remove them from price cap regulation. Price cap regulation is based on the premise that the public interest is served if LECs have incentives which are as close to the free market as possible. The public interest is not served by subjecting competitive LEC services to even more stringent regulation, as some parties suggest. Pervasive price and service regulation is no longer necessary once competition has reached a certain level. In fact, it is counterproductive and will, in all likelihood, result in the wrong signals being sent to both customers and competitors. U S WEST believes that the USTA Proposal offers the best means of accommodating competition within the price cap framework. The USTA Proposal does this by identifying competitive wire centers, or a grouping of wire centers, and removing all services in these wire centers (i.e., Competitive Market Areas) from price cap regulation.⁹²

⁹¹Price Cap Order, 5 FCC Rcd. at 6790 ¶ 28; Notice of Proposed Rulemaking, 9 FCC Rcd. at 1687 ¶ 3. And further, over time the Commission has stated on many occasions that one of its guiding regulatory objectives is to promote and protect competition, not specific competitors. See, e.g., In the Matter of Implementation of Sections 3(n) and 332 of the Communications Act, Regulatory Treatment of Mobile Services, Second Report and Order, 74 Rad. Reg. (P&F) 2d 835, 863 ¶ 105 (1994).

⁹²USTA Proposal at 24-27.

VI. OTHER ISSUES

A. Carrier Common Line Formula

Parties addressing the carrier common line ("CCL") formula fell into two groups, IXC's and LEC's. IXC's argue that the Balanced 50/50 Formula should be replaced with a per-line formula.⁹³ They claim that LEC's do not stimulate the growth of common line usage and should not be allowed to share in the benefits of this growth. LEC's either support continuation of the current 50/50 formula or its elimination.⁹⁴ U S WEST and other LEC's assert that the 50/50 formula double counts growth. That is, access customers already receive the benefit of common line growth through the productivity offset in the price cap formula. IXC's implicitly acknowledged the existence of this double counting effect by recognizing that a smaller productivity offset would be required if the Commission adopted a per-line formula.⁹⁵

U S WEST continues to support the elimination of the CCL growth adjustment (i.e., the "g" factor). Likewise, U S WEST favors a gradual transition away from the CCL charge to end-user

⁹³AT&T at 26-28; MCI at 35-40; Sprint at 15-17; WilTel at 26.

⁹⁴U S WEST at 44-45; SWBT at 47-51; Pacific at 49-52; NYNEX at 47-49; GTE at 75-77; Ameritech at 17-18; Bell Atlantic at 17-18; BellSouth at 52-53.

⁹⁵AT&T at 26-27; MCI at 39; Sprint at 12-13. Of course, LEC's and IXC's disagree on the appropriate level of the productivity offset.

charges.⁹⁶ The need for this transition will become increasingly obvious with the continued growth in access competition. U S WEST also supports NYNEX's proposal for simplifying the common line rate development process.⁹⁷ This would allow LECs to use historical rather than forecast revenues and demand in establishing end-user charges.⁹⁸

B. Exogenous Costs

In its opening Comments, U S WEST advocated the elimination of exogenous costs after the expiration of existing adjustments. A review of the comments on this issue only strengthens U S WEST's view that exogenous cost treatment should be eliminated.⁹⁹

AT&T and MCI repeat their request that the Commission modify its price cap rules to require LECs to treat fully amortized equal access network reconfiguration ("EANR") costs as exogenous costs.¹⁰⁰ AT&T and MCI base their arguments on the incorrect assumption that LECs no longer incur EANR costs. The fact is

⁹⁶See also Pacific at 51 (proposing to allow flexibility to reduce or eliminate the CCL charge and permit a cap on all end-user common line charges of \$6.00).

⁹⁷NYNEX at 49.

⁹⁸Id.

⁹⁹U S WEST continues to believe that OPEB costs are properly treated as exogenous costs under the Commission's existing Rules.

¹⁰⁰AT&T at 46-48; MCI at 47-48. See also In the Matter of 1994 Annual Access Tariff Filings, Petition of AT&T Corp., filed Apr. 26, 1994, at 1-9; MCI's Petition to Suspend and Investigate filed Apr. 26, 1994, at 19-24; In the Matter of U S WEST Communications, Inc. 1994 Annual Access Tariff Filing, Transmittal No. 465, U S WEST's Reply to Petitions to Reject or, in the Alternative, Suspend and Investigate, filed May 9, 1994, at 3-5.

that these costs continue to accrue and the Separations Rules¹⁰¹ require LECs to segregate EANR investment to the interstate jurisdiction based on equal access minutes of use.¹⁰² There is no overstatement of PCIs as a result of discontinuing the need to account for EANR rate elements separately. Thus, there is no basis for requests that the expiration of the EANR amortization should result in an exogenous reduction in LEC PCIs.¹⁰³ The

¹⁰¹47 CFR §§ 36.191, 36.421.

¹⁰²The Commission recognized this in 1985 in discussing the specialized treatment of EANR costs:

When the guarantee has expired, the equal access investment will continue to be depreciated and to be included in tariffs for access services. Such recovery can be expected over the useful lives of the assets involved.

In summary, we believe that the capital cost of equal access service is best measured in the traditional manner whereby the cost of investments are recovered over their useful lives.

In the Matter of Petitions for Recovery of Equal Access and Network Reconfiguration Costs, Memorandum Opinion and Order, FCC 85-628, rel. Dec. 9, 1985, ¶¶ 31-32; on recon., 1 FCC Rcd. 434 (1986).

¹⁰³Furthermore, the Commission recently addressed petitioners' claims in its 1994 Cost Support Order. In a letter to the Commission concerning proposals for modifications and improvements in the Commission's Tariff Review Plans ("TRP"), AT&T requested the Commission treat the ending of the separately accounted for EANR amortization as an exogenous reduction in the LEC price caps. This request was denied. The Commission responded by stating:

We decline to adopt AT&T's suggestion to treat as exogenous the completion of amortization of equal access costs. In the LEC Price Cap Reconsideration Order, the Commission rejected MCI's suggestion that the termination of equal access cost amortization should be treated exogenously, because the Commission considered equal access costs to be within the control of LECs. Because there is no requirement for price cap LECs to treat completion of amortization of equal

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Commission declined to allow exogenous treatment of EANR costs in its Price Cap Order¹⁰⁴ and in its recent Annual Access Order¹⁰⁵ and should do so herein.

As a group, LECs support continued use of exogenous cost treatment but oppose the Commission's suggestion that there is a distinction between "accounting" cost changes and "economic" cost changes.¹⁰⁶ IXC's and large users generally take the position that the Commission should adopt more stringent tests for exogenous cost treatment.¹⁰⁷ While the positions of the parties are not surprising, they do demonstrate that there will never be agreement as to which costs are appropriately treated as exogenous costs. As such, the Commission should give serious consideration to U S WEST's recommendation that exogenous cost

¹⁰³(...continued)

access costs as exogenous, AT&T's request would be a substantive change to the price cap rules and is, therefore, beyond the scope of this proceeding.

In the Matter of Commission Requirements for Cost Support Material To Be Filed with 1994 Annual Access Tariffs and for Other Cost Support Material, Order, 9 FCC Rcd. 1060, 1063 ¶ 22 (1994) ("1994 Cost Support Order") (citation omitted). Thus, MCI's claim in its comments in this proceeding that the Commission never addressed the EANR amortization "then in effect" when the Commission adopted the Price Cap Rules is clearly incorrect.

¹⁰⁴In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd. 2873, 3190 ¶¶ 655-57 (1989). See also, Price Cap Order on Reconsideration, 6 FCC Rcd. at 2665 ¶ 64.

¹⁰⁵In the Matter of 1994 Annual Access Tariff Filings, CC Docket No. 94-65, Memorandum Opinion and Order Suspending Rates, DA 94-706, rel. June 24, 1994 ("Annual Access Order").

¹⁰⁶See, e.g., BellSouth at 55; SWBT at 51; Rochester at 21-22; NYNEX at 56.

¹⁰⁷See, e.g., WilTel at 27; MCI at 41-49; ICA at 16-17.

treatment be discontinued after the expiration of existing adjustments. Exogenous cost adjustments are a deviation from "pure" price cap regulation which reduce efficiency incentives.

C. Sales and Swaps of Exchanges

In its Notice of Proposed Rulemaking the Commission asked whether the price cap rules governing mergers and acquisitions should be revised to prevent unreasonable cost shifting and maintain the incentives of the price cap plan.¹⁰⁸ U S WEST responded to this inquiry by stating that sales and purchases of exchanges by price cap LECs are no different than selling, retiring, depreciating, or purchasing any other asset.¹⁰⁹ U S WEST went on to note that any question as to whether exogenous cost treatment would be appropriate would disappear if the Commission adopted U S WEST's suggestion that exogenous cost treatment be eliminated.¹¹⁰ While U S WEST continues to maintain this position, the comments of other parties require a response.

AT&T and MCI argue that price cap LECs selling high cost exchanges should be required to pass through cost savings to access customers through an exogenous cost adjustment to LEC

¹⁰⁸Notice of Proposed Rulemaking, 9 FCC Rcd. at 1703-04 ("Baseline Issue 10: Sales and Swaps of Exchanges. . . . Whether, and how, the process for granting waivers of the price cap rules governing mergers and acquisitions or the price cap rules themselves should be revised so as to prevent unreasonable cost shifting and maintain the efficiency incentives of the LEC price cap plan.").

¹⁰⁹U S WEST at 64.

¹¹⁰Id. at 65.

PCIs.¹¹¹ MCI argues that any such exogenous cost adjustment should also include any additional access costs that customers incur as a result of an exchange sale.¹¹² Most other parties, including price cap LECs, small LECs, and large users, find the existing price cap rules to be adequate and oppose modifications to these rules to govern sales and swaps of exchanges.¹¹³

The Commission should reject the proposals of AT&T and MCI. These proposals do not serve the public interest, only AT&T's and MCI's private interests. This is not the proceeding in which to resolve problems AT&T and MCI have with the support mechanisms the Commission has established for high cost areas. There is no justification for requiring price cap LECs who sell exchanges to adjust their PCIs for any changes in subsidies that buyers of these exchanges may receive (e.g., weighted DEM and USF payments). These subsidies should be treated no differently than any other high cost subsidies. Similarly, as buyers provide cost support for their own access rates, it is inappropriate to require buyers to maintain the same access rates as those charged by the previous owners.

While U S WEST opposes the adoption of any price cap rules which mandate the exogenous treatment of the sales of exchanges, U S WEST will continue to voluntarily adjust its PCIs to reflect the removal of revenue requirements and revenues associated with

¹¹¹AT&T at 51-52; MCI at 59-61.

¹¹²MCI at 60-61.

¹¹³BellSouth at 70; GTE at 80; Ad Hoc at 32; ICA at 24; OPASTCO at 2-3; USTA at 93-94; NRTA at 4-5.

any exchanges that it sells.¹¹⁴ The Commission should continue to assess these transactions on a case-by-case basis. No public purpose would be served by erecting any further obstacles to the sale or swap of exchanges between price cap LECs and others.

D. Service Quality and Infrastructure Monitoring

Most parties responding to the Commission's inquiries on service quality and infrastructure reporting requirements recommend that the Commission either reduce these requirements or maintain the status quo.¹¹⁵ Only two parties advocate any expansion of reporting requirements -- TCA and Pacific.¹¹⁶

Pacific proposes a relatively minor expansion in reporting requirements while TCA advocates comprehensive changes.¹¹⁷

U S WEST opposes both parties' proposed modifications.

U S WEST is perplexed by some of Pacific's proposed modifications since they appear to be both burdensome and redundant. For example, Pacific's proposed expansion of Table II, ARMIS

¹¹⁴U S WEST Communications Tariff FCC No. 3, Transmittal No. 466, 1994 Annual Access Charge Filing, § 1.2.5 at 1-7 through 1-10, Workpapers 5A & 5B, filed Apr. 1, 1994.

¹¹⁵See, e.g., BellSouth at 58; SWBT at 63; Ad Hoc at 27-28; MCI at 50-51; Sprint at 20; USTA at 92-93; Ameritech at 20-21; NYNEX at 52-53; GTE at 79-80; Rochester at 23.

¹¹⁶Teleport Communications Group ("TCG") also asserts that LECs "subsidize" the quality of their competitive services by providing poor service to monopoly customers. TCG at 15 n.12. This is nonsense. TCG is grasping at straws to bolster its arguments that LECs must be kept in a regulatory "straitjacket" to protect competitive entrants.

¹¹⁷Pacific at 55; TCA at 7-8, 11.

43-07, appears to duplicate data contained in the Commission's comprehensive report on fiber deployment.¹¹⁸

Prior to addressing TCA's proposals, U S WEST feels compelled to comment on TCA's survey. TCA uses the results of this survey to draw conclusions about the quality of U S WEST's service. TCA's survey is wholly inadequate and cannot substantiate its conclusion. The survey is statistically invalid and cannot be used to draw any conclusions about U S WEST's quality of service.¹¹⁹ TCA's claim that its survey "reveals certain

¹¹⁸Fiber Deployment Update -- End of Year 1993, Industry Analysis Division - Common Carrier Bureau, May 1994.

¹¹⁹The reliability and validity of TCA's survey methodology is questionable for three reasons -- inadequate sample size; respondents were not selected at random; and the survey cannot accurately predict trends in service quality with a single survey made in 1994.

a) TCA's Survey's Sample Size is Inadequate to Draw Reliable Conclusions

The sample size is not large enough to draw conclusions about the population of small, medium and large business customers of U S WEST. The conclusions drawn about U S WEST's service quality reflect responses from only 64 of its customers.

With a sample size of 64, the range of error is quite large (+ or - 12 percent at a 95 percent confidence level). For example, the TCA survey states 34 percent of the customers surveyed reported service personnel to be less experienced than four years ago. The range of error means that to be 95 percent confident of the accuracy of the results, it can be said only that this percentage ranges from 22 percent to 46 percent. In general, a sample size of 400 (assumes a 95 percent confidence level) would be required to bring the range of error to an acceptable level of + or - 5 percent.

b) TCA's Survey Respondents were not Randomly Selected

The sample of U S WEST customers was not drawn at random as all respondents are members of the TCA. For survey results to be representative of a certain group of customers, each U S WEST customer must have a known and equal chance of being selected to

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danger signals confirming the need for enhanced scrutiny" is totally without basis.¹²⁰ In order to dispel any underlying concerns about how customers perceive the quality of U S WEST's service, U S WEST has attached a copy of its recent submission of FCC Report 43-06, ARMIS Semi-Annual Service Quality Report, Table 1, Customer Satisfaction, for the second half of 1993.¹²¹ In compiling the information for this report, U S WEST surveyed more than 1100 business customers in each of the 14 states which encompass U S WEST's service area. This report shows that the percent of satisfied business customers range from 83 to 92 percent for the different states, with an error range of plus or minus five percent at a 95 percent confidence interval.

TCA uses its survey results and its observations that LECs have reduced their work forces, competition is growing unevenly, and data transmission is growing rapidly to claim that quality of service reporting refinements are warranted.¹²² TCA's proposed

¹¹⁹(...continued)
participate in the survey.

c) TCA's Survey does not Include Actual
Responses from 1990

TCA determined "better" or "worse" service by asking customers to compare current quality of service to the quality of service in 1990. A more accurate method of determining changes over time would be to test for statistically significant changes in customer responses based on measures obtained in 1990 compared to measures taken in 1994.

¹²⁰TCA at i.

¹²¹See Attachment 2.

¹²²TCA at ii.

refinements remain unchanged from its past advocacy.¹²³ These proposed refinements include: 1) exception reporting by wire center; 2) exception reporting for MSAs or non-MSAs that lag behind in deployment of key technologies; and 3) expanding reporting requirements to include information on data transmission quality (i.e., information on errored second and severely errored second ("ES/SES")).¹²⁴ U S WEST opposes all three refinements. TCA, alone, has raised the issue of exception reporting by wire center.¹²⁵ U S WEST objects to this and similar proposals on two grounds. First, adoption of such a proposal and the establishment of threshold levels would inevitably lead to the adoption of de facto standards. This is something the Commission has opposed in the past.¹²⁶ Second, in order to determine whether the selected threshold is exceeded, a LEC would have to collect and compile data on a wire center basis. This would be a significant burden for U S WEST -- a company with more

¹²³See In the Matter of Modifications to Service Quality/Infrastructure Reporting, AAD 92-47, Comments of Telecommunications Association filed Aug. 11, 1992, at 3-12; In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Reply Comments of Telecommunications Association filed Apr. 5, 1991, at 7-11; Application for Review of TCA filed June 17, 1991, at 18-24.

¹²⁴TCA at 9-11.

¹²⁵The Common Carrier Bureau has declined to require such reporting in the past. See In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Memorandum Opinion and Order, 8 FCC Rcd. 7474, 7476 ¶¶ 9-12 (1993).

¹²⁶Price Cap Order, 5 FCC Rcd. at 6830 ¶ 359; see also In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Memorandum Opinion and Order, 6 FCC Rcd. 2974, 2990-92 ¶¶ 41-44, Attachment B at 3026-27 ¶ 2 (1991) ("Service Quality Order").

than 1700 wire centers.¹²⁷ The burden on the Commission could also be quite significant, given the inevitable disputes over threshold levels and the existence of thousands of wire centers throughout the United States.¹²⁸

U S WEST does not collect ES/SES data today for digital circuits.¹²⁹ U S WEST's monitoring system has set threshold levels. When a circuit's performance exceeds the threshold, an alarm is triggered and investigated. No data on individual circuits is retained or aggregated for reporting purposes.

U S WEST is also opposed to TCA's proposal to expand quarterly monitoring reports to include information on errored and severely errored seconds. The Common Carrier Bureau has previously considered and declined to adopt this proposal within the

¹²⁷As noted in previous filings, some of the service quality data currently reported to the Commission is unavailable by wire center. In the Matter of Modifications to Service Quality/Infrastructure Reporting, AAD 92-47, U S WEST Reply Comments filed Sep. 1, 1993, at 12-13; In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, U S WEST Petition for Reconsideration and Clarification filed Nov. 12, 1993, at 11-12.

¹²⁸Additionally, U S WEST does not support TCA's proposal to provide exception reporting of individual MSA or non-MSA areas in the lowest quartile for deployment of key technologies. Technology deployment decisions should be made on the basis of customer need, market analysis, and economic feasibility, rather than mandated by the Commission.

¹²⁹In considering data transmission quality reporting requirements, the Commission should bear in mind that analog transmissions are quite different from digital transmissions; analog transmissions usually degrade over time. Customers are usually aware of and affected by the degradation. Digital transmissions, however, do not degrade over time. The customer is unaffected by any degradations until such time as the signal is gone. At that time, the monitoring system would see that the threshold had been crossed and trigger an alarm. Because of these differences, reporting digital transmission quality is neither necessary nor meaningful.

last year,¹³⁰ and the Commission should do the same in this proceeding. Data transmission monitoring of bit error rate was rejected as "intrusive on service and costly and burdensome to the LECs, and thus fails to achieve the Commission's desired balance of usefulness with burden."¹³¹

VII. CONCLUSION

As U S WEST demonstrates in the foregoing Comments, commenters' recommendations that LEC PCIs be reduced -- to reflect declines in the cost of capital, increases in LEC earnings above the previously authorized rate of return, and LEC productivity gains in excess of 3.3 percent -- are inconsistent with price cap regulation. Adoption of any of these proposals will represent a step backward toward rate of return regulation -- not an improvement in price cap regulation. U S WEST urges the Commission to modify the LEC price cap plan as delineated in U S WEST's opening Comments. To reiterate, the Commission should concentrate its efforts on achieving three simple goals in this proceeding:

- 1) remove the last remnants of rate of return regulation from price cap regulation;
- 2) modify the price cap plan to accommodate competition; and
- 3) streamline the rules for introducing new services.

¹³⁰Supra note 127.

¹³¹Public Notice, 7 FCC Rcd. 4632, 4634 ¶ d. See also Service Quality Order, 6 FCC Rcd. at 2980.

By doing so, the Commission can take a major step toward the use of true incentive regulation and smooth the way for greater competition in the interstate access market.

Respectfully submitted,

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Attachment 1

TRIGGER MECHANISMS

Several parties set forth proposals for trigger mechanisms based on measures of competition in local exchange markets. For example, MFS proposes a trigger mechanism based almost entirely on the extent of competition within local exchange markets.¹ Other parties suggest similar triggers based on local exchange competition.²

In our Reply Comments, U S WEST demonstrates that delaying the ability of LECs to respond to competitors in the interstate access market will only harm competition, defer the benefits of competition to consumers, and misplace resources as inefficient providers build networks in response to false economic signals. The Commission should therefore reject the adoption of any such trigger mechanism that would unreasonably postpone a LEC's ability to respond to competition.

In this Attachment, U S WEST responds to some of the more inappropriate trigger mechanisms proposed by LEC competitors.

A. TCG

TCG proposes use of the Horizontal Merger Guidelines used in merger enforcement matters by the Department of Justice and the Federal Trade Commission "in reverse" to see if a previous monopoly market has become sufficiently competitive. TCG would use the Herfindahl - Hirschman Index ("HHI") of market concentration, which is the sum of the squares of the individual

¹MFS at 46-49.

²See, e.g., AT&T at 16-19; MCI at 67-72; TCG at 17-27; Time Warner at 12-13.